

Not for Publication or Citation

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

IN RE: CASE NO. 09-13677)	
)	
DANNY LEE KREIS)	
)	
Debtor)	
)	
)	
ALVA BUTLER)	
SANDRA BUTLER)	
)	
Plaintiffs)	
)	
vs.)	PROC. NO. 09-1213
)	
DANNY LEE KREIS)	
)	
Defendant)	

DECISION

At Fort Wayne, Indiana, on January 19, 2011.

This adversary proceeding asks the court to determine the dischargeability of the debtor/defendant's obligation to the plaintiffs. That obligation is represented by a judgment issued by the Steuben Superior Court, which was affirmed by the Indiana Court of Appeals. It arises out of the debtor's lease of real property from the plaintiffs and his occupancy of that property. Based on the state court's findings of fact and conclusions of law, the judgment has three components. The first component awarded \$11,284.10, representing treble damages and attorney fees pursuant to I.C. 34-24-1-1, as a result of the debtor's conversion of property. The second component resulted in the award of \$20,571 for unpaid rent and the costs of repair to the leased premises. Finally, the plaintiffs recovered \$10,647.62, pursuant to both the lease and Indiana's treble damage statute, as the reasonable costs, expenses and attorney fees in bringing the action. There is no dispute that the award of treble damages – \$11,284.10 – is excepted from discharge, pursuant to § 523(a)(6), as a

debt for a willful and malicious injury. Similarly, there is no dispute that the \$20,571 awarded for unpaid rent and the cost of repairs is dischargeable. Instead, the dispute focuses on the dischargeability of the fees and expenses the plaintiffs recovered. Additionally, the plaintiffs successfully collected \$4,384.25, through garnishment, a few years prior to the petition. The parties dispute how this payment should affect the dischargeability determination. Plaintiffs argue that it should be applied to the dischargeable portion of the obligation, while the debtor argues that it should be applied to the non-dischargeable component. The matter is before the court following trial of these issues.

A creditor bears the burden of proving that a debtor's obligation to it is non-dischargeable, see, Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654 (1991), and, when necessary, proving the amount of the non-dischargeable debt. See e.g., In re Mills, 2008 WL 2787252 (Bankr. D. Idaho 2008); In re Novak, 97 B.R. 47, 62 (Bankr. D. Kan. 1987). When it comes to add-ons, such as costs, expenses and attorney fees, the rule is that the dischargeability of those additional components is determined by the dischargeability of the underlying debt; it does not matter whether the basis for the additional award is a matter of contract or statute. See, Cohen v. de la Cruz, 523 U.S. 213, 118 S.Ct. 1212 (1998); Matter of McFarland, 84 F.3d 943 (7th Cir. 1996); Matter of Mayer, 51 F.3d 670 (7th Cir. 1995); In re Gard, 327 B.R. 372, 377-78 (Bankr. N.D. Ind. 2003); Matter of Clifton, 1996 WL 931683 (Bankr. N.D. Ind. 1996). As a result, if a contractual obligation is procured through a debtor's fraud and the contract carries with it a right to recover fees and expenses, the same fraud that makes the underlying contractual debt non-dischargeable also renders the associated obligation to pay fees and expenses non-dischargeable. Similarly, if a statute creates a liability and a right to recover not only damages, but also attorney fees and expenses, if the conduct which results in the underlying statutory liability renders a debt non-dischargeable, the associated fees and expenses the

statute allows to be recovered are also non-dischargeable.

In the original trial before the state court, the plaintiffs sought to recover more than \$22,800 in fees and expenses that had been incurred prior to trial. The state court determined that both the lease and I.C. 34-24-3-1 allowed the plaintiffs to recover their reasonable fees, costs, and expenses, but that the reasonable fee for securing the judgment the plaintiffs recovered was only \$10,000, not the \$22,800 they sought. How the state court came to that amount is not known. We know only that the plaintiffs sought more than \$22,000, and that a reasonable fee was determined to be \$10,000. Why the court felt the other \$12,800 was not reasonable is not known. It made no findings (and neither did it need to) concerning what aspects of counsel's fees were not reasonable and whether they related to the dischargeable contractual claim, the non-dischargeable statutory claim or to a claim for damages as a result of unauthorized alteration of the premises upon which plaintiffs did not succeed at all.

In this court, the plaintiffs submitted a copy of the affidavit for attorney fees that had been presented to the Steuben Superior Court which itemizes the time and services counsel rendered to his clients. On that affidavit counsel has indicated what part of any particular time entry should be associated with the statutory claim – although how or why counsel made that allocation was not explained. The result of his analysis is that of the total time devoted to the matter – 152.10 hours – 70.8 hours was associated with the statutory claim for treble damages, which at counsel's standard hourly rate yields a value of \$10,620. Since this number exceeds the amount awarded by the state court, in this court, the plaintiffs argue that the entire fee award should be non-dischargeable.

Although counsel's math may be correct, the court cannot embrace the conclusion he asks us to draw. The state court never made any findings about the reasonableness of any particular aspect of the fees the plaintiffs sought. We know only that they sought more than \$22,000 and the

court determined \$10,000 was a reasonable fee; in other words more than \$12,000 of the amount sought was unreasonable. Why it was unreasonable or what aspects of the fees sought were unreasonable is not known and this court is not in a position to revisit the state court's findings; neither does it have sufficient information with which to do so. Nor can we assume, as the plaintiffs ask, that the reasonable attorney fees associated with the statutory claim are all included in the \$10,000 the state court awarded and the unreasonable \$12,000 were all associated with the dischargeable contractual claim. We know only that plaintiffs had two successful claims, both of which carried a right to recover costs, expenses and attorney fees and that the reasonable fee for pursuing both of them was \$10,000. We do not know and, based on the information available, cannot tell what portion of that \$10,000 might be appropriately attributable to the non-dischargeable statutory claim and what portion might be attributable to the dischargeable contract claim. As a result, although the plaintiffs have proven that there might be a non-dischargeable debt lurking around somewhere in the attorney fee award, they have failed to carry their burden of proving the amount of that non-dischargeable debt. See, Mills, 2008 WL 2787252; Novak, 97 B.R. at 62.

The second aspect of the parties' dispute concerns the application of the payments that were made toward the judgment prior to the date of the petition. Those payments resulted from the plaintiffs successful garnishment of various amounts otherwise due the debtor and total \$4,384.25. The parties dispute whether they should be applied to the non-dischargeable component of the plaintiffs' judgment (defendant's argument) or to the dischargeable portion of the judgment (the plaintiffs' argument).

When it comes to the application of payments, the traditional rule is that, absent any agreement, a debtor who voluntarily pays a creditor can instruct the creditor where the payment should be applied. If it does not do so, the creditor is free to make an application as it sees fit. If

neither of the parties makes any application of payments, so that the court is required to do so, its decision is to be guided by equitable principles. See, In re Stone's Will, 248 N.W. 446, 451 (Wisc. 1933). See also, In re Scannell, 60 B.R. 562, 564 (Bankr. W.D. Wisc. 1986).

Until bankruptcy and the resulting prospect that the debtor's obligation to the plaintiffs would have both dischargeable and non-dischargeable components, neither of the parties ever thought about how any payments should be applied or the consequences that might have. The debtor never gave any instructions concerning the application of payments when those payments were made. (It would not, however, have mattered since all of the payments were made involuntarily, through a garnishment, rather than voluntarily.) Neither did the plaintiffs make an allocation of those payments between the various components of the judgment (past due rent, attorney fees, statutory damages, etc.). Accordingly, the court must do so, and its decision is to be guided by equitable principles.

Rather than arguing for some sort of equitable division of the payments, both parties have adopted an all or nothing approach. The plaintiffs, in order to maximize their recovery and to give better effect to Congress's declaration that certain obligations are non-dischargeable, contends all of the payments should be applied to the dischargeable portion of the judgment debt. The debtor on the other hand, in order to minimize his exposure and to enhance the fresh start a bankruptcy discharge is to provide, argues that the payments should be applied toward the non-dischargeable portion of the judgment.

The court rejects the all or nothing approaches that the parties urge upon it. While it understands the goals that both the discharge and a declaration of non-dischargeability were designed to attain, it does not believe that it must give preference to one goal over the other. Instead, those goals can be balanced and harmonized, in the same way that Congress has tried to balance and

harmonize the competing interests of debtors and creditors when it comes to the bankruptcy law itself: for example, discharge versus no discharge; dischargeable debts versus non-dischargeable debts; and distribution to creditors versus protecting assets and exemptions for a debtor. The best way to do so here is to recognize that the debtor's obligation to the plaintiffs has both dischargeable and non-dischargeable components and to allocate the payments between them accordingly.

Plaintiffs judgment against the debtor totals \$41,855.10. Of that total, \$11,284.10 – or 26.9% – is non-dischargeable; the remainder is dischargeable. The funds the plaintiffs were able to collect toward the total judgment debt prior to the bankruptcy should be applied to the non-dischargeable and dischargeable aspects of the judgment, on a pro rata basis. Accord, Scannell, 60 B.R. at 565. As a result, of the \$4,384.25 the plaintiffs collected from the debtor prior to bankruptcy, \$1,179.36 should be applied to the non-dischargeable component.

Based on the foregoing, the defendant's obligation to the plaintiffs, represented by the judgment of the Steuben Superior Court in Case No. 76D01-0308-PL-421 is non-dischargeable to the extent of \$11,284.10, together with any accruing post-judgment interest thereon. Of the payments collected, \$1,179.36 should be applied toward the non-dischargeable portion of that judgment. Judgment will be entered accordingly.

/s/ Robert E. Grant
Chief Judge, United States Bankruptcy Court